REFLECTIONS ON AN ECONOMIC ANALYSIS OF THE IDEA OF ARBITRATION IN BRAZIL: INITIAL THOUGHTS

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Abstract: This article aims to provide initial thoughts on some important considerations regarding the advantages of adopting arbitration from economic concepts. The goal is to demonstrate how arbitration can be a method of dispute resolution that tends to reduce the transaction costs of the economic agents in order to become an efficient alternative to State Courts. For the preparation of this paper, we propose its division into three parts. First, we explain that arbitration actors, especially companies, traditional users of arbitration, are rational agents seeking to maximize profits and therefore must negotiate and adopt the dispute resolution method that reduces transaction and opportunity costs. In the second part, the characteristics of the idea of arbitration are analyzed to demonstrate that it can reduce the transaction costs. In the third part, the reality of the Brazilian judiciary system will be analyzed, referring mainly to the slowdown of the Brazilian Courts, economic incentives and the lack of economic incentives, demonstrating that the non-adoption of arbitration in Brazil generates high opportunity costs. Finally, concluding remarks are made, providing suggestions.

Keywords: Law and Economics; Economic Analysis; Arbitration; Transaction Costs; Opportunity Costs; Arbitration.

INTRODUCTION

The advantages of the idea of arbitration are well known. Nevertheless, despite having already been researched by some through the point of view of economic concepts, even some important economic empirical researchers, the advantages of arbitration have seldom been explained with economic tools or with the ideas of best practices in order to facilitate its adoption. This is due to legal reasoning on the basis of legal doctrine, the basis of the arbitration community, which usually does not offer analytical tools to accurately measure the extent of the unincurred costs problematic and, in other words, the price parties have to pay to solve the dispute via the chosen method of resolution, options that parties have to solve its dispute.

In this sense, without the lens of economics science, if using the starting point of the superficial premise that cost is synonym to financial payment, one could believe that arbitration is expensive when compared to the state method of dispute resolution judiciary. However, on the other hand, if a few economics concepts are applied, the different opposite conclusions is often reached from legal dogmatic.

Faced with this realization, therefore, the goal of this essay is to present some reflections on an economic analysis of arbitration in order to demonstrate that the “idea of arbitration” may be a dispute resolution method capable of reducing transaction costs involved in economic operations and of avoiding opportunity costs. Although no specific arbitration law has been adopted, regarding the possibility of adopting utilizing the general state notions of the idea of modern arbitration, this essay is based on Brazilian jurisdiction for the unavoidable comparison between arbitration and its judicial system and the judiciary.

Therefore, initially, the premises of economic premises cited herein will be analyzed (I) in order to understand the choices of the firm’s choice – the rational economic utility maximizer agent, and arbitration’s maximizer and consumer/customer. A reflection will follow, as to the possibility of reducing transaction costs (II) allowed provided by the election of arbitration, as well as an assessment of the cost of opportunity cost incurred by not adopting arbitration to resolve commercial disputes in Brazil (III). Finally, a conclusion is provided will be proposed.

I. THE FUNDAMENTAL ECONOMICS CONCEPTS OF THE DECISIONS OF THE ECONOMIC AGENT IN OPTING FOR ARBITRATION

The idea of commercial arbitration is based on party autonomy. Those involved in an economic transaction may opt for arbitration, as a general rule, as a method of dispute resolution. This shows whether affirmative or negative, is a rational choice. There lies the need to explain this rational choice.

Throughout the years, many premises were developed by economics to explain the choices economic agents make. Among them, there is the premise that economic agents are (at least to a certain extent) rational and maximizers of the utility maximizer of resources. This concept stems from the basic concept of economics, i.e., the resources are scarce. Consequently, however, shortage in itself forces economic agents to make decisions, which must then maximize the utility of those use of resources. This is called the theory of the rational choice theory: each individual, or rational agent, classifies alternatives and makes choices according to the level of satisfaction provided, i.e., attributes a utility to each possible choice and is capable of organizing such choices according to the utility provided little each of them provides to him. Since in the real world the alternatives available to individuals, economic agents are scarce – the resources are limited – an economic agent classifies the available alternatives depending on the level of satisfaction provided. This also explains why agents respond to incentives; if the level of satisfaction of the options is increased or reduced, the choice is altered.

Thus, a way of maximizing these choices and extracting the best utility possible out of exchanges is through the firm, the business organization, the agent present in most part almost all of

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3 The expression “idea of arbitration” is used in the same way as was used by Jan Paulsson [Ver PAULSSON, J. (2013) The Idea of Arbitration. Oxford.] considering that this text does not deal with an arbitration law in particular, despite being centered on Brazilian jurisdiction, but with the idea of a dispute resolution method sustained by several internationally known principles instead, such as competence-competence, the autonomy of the arbitration clause, pathological clause, arbitrator independence, and autonomy of the parties, present in instruments such as the 1958 New York Convention, the UNCITRAL Model Law and, consequently, also in Brazilian Law n. 9,307/1996.

arbitrations. Coase, in *The Nature of the Firm*, forged the first path towards the understanding and operation of the firm, as he sees it as the space capable of coordinating actions of economic agents, alternative to the market, in a manner which they could organize inputs to combine efficiency to their final product. This organization of inputs would then be consolidated by the firm through a vast range of contractual arrangements with all the participants of its business life.

The firm, as a rational and maximizer economic agent, aims therefore at increasing its utility, mostly and large through the difference between the incomes and the costs. The best choices, the more rational ones, are therefore those with the fewest costs and the highest incomes. And in order to be able to assess their utility, it is important to stress that the costs of the firm include not only the production costs, but also the transaction and opportunity costs. Thus, the rational economic agent, the firm, will always seek to reduce those transaction and opportunity costs. But what do these transaction and opportunity costs consist in?

The transaction costs were illustrated in Coase’s aforementioned work. Whilst the classic economy theorized that the market would be a perfect mechanism of price formation, mechanism of prices, it was his understanding that, in the real world, the market is not perfect and is not the only economic organization feature, which is why it is not the sole mechanism of organization of economic activity. Market Frictions would arise imperfections then arises, which is related to the existence of costs associated to the use of instant performance contracts. This fact is the basis creates economic incentive reason for the creation of incentives for economic agents to establish new ways of organizing economic activity, capable of avoiding costs.

Therefore, it has been verified that these costs, possessing a nature different from production costs, were referred to as “transaction costs”, since they related to the way in which a transaction is processed. Coase identified them as being all costs that hindered the occurrence of a transaction. According to him in his theorem suppose  that individuals would necessarily contract interchange until attaining efficiency that is in the event that the transaction costs were zero. Thus, transaction costs cover the three steps of a commercial transaction: (i) cost of the search to do business; (ii) cost of negotiation, and (iii) costs of complying with what was negotiated.

All types of transaction costs are of interest to this analysis. The first areas related to the obtaining of information concerning the market, legislation, and occasional commercial partners. Negotiation costs are those incurred during the negotiation of the contract. The faster the parties’ wills meet and this is formalized, the fewer the costs of attorney’s fees, the time of the parties and other resources involved, for example. As for the costs of non-compliance with what was negotiated are a more significant part of the transaction costs, at least for this study. They contain, for example,

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2 The concept of efficiency is basic in the understanding of Law and Economics. Objectively, a production process is deemed efficient when any of the two following conditions is in forces: 1. It is not possible to generate the same production quantity used in the combination of lower-cost inputs; or 2. It is not possible to generate more production using the same combination of inputs. (COOTER, Robert; ULLEN. *Direito & Economia*. 5. ed. Porto Alegre: Bookman, 2010, p. 38).
4 COASE, Ronald H. (1960). *The problem of social cost*. 3ª Journal of Law and Economics, p. 1-44. In his words “In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on. These operations are often extremely costly, sufficiently costly at any rate to prevent many transactions that would be carried out in a world in which the pricing system worked without cost.”
5 Cooter e Ulen page 89.
6 Cooter e Ulen page 92.
the cost of conflict resolution, which covers the administrative costs of the procedure, the costs proportional to the delay in allocation of property, the costs of mistake in judgment, the cost of probability of inefficient dispute resolution procedure, inefficiency, and the cost of publicity of the transaction.

The cost of opportunity cost, in turn, is the “price” that indicated the economic cost of an alternative that was left aside, that was overlooked, i.e. the allocation cost alternative to that scarce resources.

This opportunity cost has at least two applications for this essay.

First of all, the opportunity cost instigates the economic agent to evaluate the choice between the alternatives, since the mere possibility of choice already generated a cost. If he chooses a disputes resolution method, for example, the cost of not opting for the alternative should be added to the cost of the dispute resolution chosen, and vice versa. The maximization agent is interested in the choice of an alternative disputes resolution method that minimizes the least opportunity cost.

Second of all, the opportunity cost includes the allocated cost alternative to the resource, the property right, for which a different allocation is sought. It is thought, for example, that to dispose of one million today is different from disposing of the same sum seven years from now (regardless of adjustment for inflation).

Based on these brief and fundamental concepts of economic analysis, it is important to analyze the idea of arbitration with respect to the economic incentives to its use, especially those derived from the reduction of transaction and opportunity costs.

II. THE IDEA OF ARBITRATION AS AN INSTRUMENT OF TRANSACTION COSTS REDUCTION

As previously mentioned, the reasons for parties to choose arbitration are known by the dogmatic approach, legal dogmatism. Among them are celerity, confidentiality, arbitrator expertise, openness, neutrality, and the circulability/movability of the award/judgement’s ability to circulate, to state a few. The disadvantages are known in the same manner, such as the relative high cost and impossibility of appeal of an arbitral award. But what is the relation between such advantages and disadvantages and the transaction costs? These transaction costs are precisely those that arbitration is able to reduce.

Nevertheless, it has been said that the economic agent seeks to reduce the transaction costs, thus tending to prefer a dispute resolution method that achieves this goal, which is efficient. There is no other reason for the parties to adopt and why they should adopt arbitration. Indeed, the existence of this doctrine in itself would serve as proof of its economic efficiency, for those who believe in neo-institutionalist economies, which presumes that society gradually – through trial and error – models its formal and informal rules and institutions. This is due to the fact that said characteristics of arbitration are exactly those able to decrease transaction and opportunity costs, and finally justify its adoption. Therein lies this text’s interest in explaining the advantages of arbitration through economic concepts.

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11 Said authors demonstrate opportunity cost with the following example: “when you decided to attend university, a graduate program, or law school, you gave up on other valuable alternatives, such as, for example, getting a job, or training for the Olympic Games.” (COOTER, Robert; ULLEN, Direito & Economia. 5 ed. Porto Alegre: Bookman, 2010, p. 53). Bringing this example to law, the unavailability of the economic goods for a long time during the judicial proceeding, increases the cost of waiver to such goods, as well as reduces the benefits which could be obtained from these waived assets.

12 It is important to clarify that the property right does not refer to the notion of real right present mainly in civil law countries. The property rights express the a person’s subjective right, which guarantees its utility and enables efficient allocation. See KIRAT, T. (2012) Économie du Droit. La Découverte. Paris. Page 59.
Therefore, there is support to the idea that arbitration may reduce negotiation costs (A), administrative costs of dispute resolution (B), costs of delay in allocation of property (C), costs of error costs in the judgment (D), publicity costs (E), and costs of inefficient use of procedure (F). One can also believe that it may reduce search costs for offering a “safe haven” for the foreign investor, but more in-depth works about this already exist. International studies prove the foreign investor’s preference for arbitration, such as the World Economic Outlook (WEO) and Doing Business (DB) reports, as well as economic data made available by the World Bank on its Databank.

II.A The reduction of negotiation costs

The negotiation costs may be reduced with the adoption of an arbitration clause. If, on the one hand, negotiation costs of the arbitral clause itself exist, such as the negotiation for choice of an arbitration regulation, of the seat and language of the arbitration, for example, on the other hand, they are decreased by allowing the use of equity, of principles not specific to any particular nationality, like the UNIDROIT Principles for instance, or even by facilitating the election of a neutral adjudicator, whose nationality is different from that of any of the parties.

This can be illustrated with the negotiation case of an international transaction in which the parties are not able to reach an agreement with regards to the applicable law or their choice of court. Despite the argument that could be made that private international law of the jurisdictions that possess a contact with the legal relationship intends to reduce this negotiation cost, this would not be true since the choice of a neutral law or court in many cases is a condition sine qua non for doing business.

In any case, it is believed that this cost of contract negotiation cost notably when international, concerning the choice of the rules related to procedure and to merit, through which the resource will be allocated, would be further reduced when an arbitration clause is adopted, precisely because it facilitates the adoption of a common language, of a neutral seat, and of a regulation of a renowned arbitration institution, often already mutually known by the parties.

II.B The reduction of administrative costs of the dispute resolution procedure

Arbitration may reduce the administrative costs of the dispute resolution procedure. The uncertainty of this statement results from contract economy and from the conditions stipulated by the parties, since, before any economic approach is made, one must understand that administrative costs will be involved in any dispute resolution procedure, such as in the judiciary. The uncertainty is emphasized with the different costs the judiciary presents in various countries, which leads to jurists having inconclusive perceptions.

13 Available at: http://databank.worldbank.org/. Also used, information made available by the World Bank through the Index of Economic Freedom (available at: http://www.heritage.org/index/about) brings a synthesis of the so-called institutional environment of each country, apart from preparing a world ranking according to the indexes of economic freedom.

14 Through the analysis of these studies, it is possible to objectively identify the link between economic development, Foreign Direct Investment, and international commercial arbitration. To mention an example, the World Bank, in its Doing Business report, analyzes how easily economic agents can do business in different countries, based on, among other factors, the performance of contracts and the role of private conflict resolution methods play. It is understood that international commercial arbitration is an important milestone in the structure of incentives related to the performance of contracts (enforcing contracts).

the arbitral procedure cost is high, especially when dealing with more renowned institutions. This is because, apart from the cost of the institution that manages the procedure, there are arbitrator fees, fees of the parties’ attorneys or representatives, travel and transportation expenses, logistics and transportation costs, expert fees, among others.

However, it is believed that the idea of arbitration allows the reduction of administrative costs of dispute resolution administrative costs, for different reasons. Firstly, arbitration grants to the parties the possibility to coordinate the procedure without necessarily having an institution or rendering professional services of litigation management, such as in ad hoc arbitrations, for example. Even if there is a strong argument that, by avoiding this cost, the parties generate inefficiency with the lack of an established consistent procedural and procedure efficiency, which leads to arbitrations being mostly institutional in practice, the freedom of choice ultimately stimulates the maximization agent to opt for chambers that provide a better cost-benefit, considering that these arbitral institutions, also rational maximizing enterprises, tend to become more and more attractive to users, reducing their fees, optimizing their services, and modifying their arbitration rules in order to obtain more efficiency in the procedure and also reduce the parties' transaction costs. The parties' freedom to choose a procedure, inherent to the idea of arbitration, tends to reduce the administrative costs because it generates competition in the arbitration market.

Secondly, the arbitrator’s fee, very feared by some and desired by others, represents part of the administrative costs of arbitration. Therefore, the fear does not represent a true obstacle in the reduction of administrative costs through arbitration. In truth, cost of arbitrator fees and administration fees do not generally exceed 15% of the total litigation costs. In addition, there are other arguments in favor of a greater economic efficiency of arbitration related to administrative costs. The first stems from the economic argument: there is a professional market for the rendering of arbitrator services and there is a big competition, setting aside any criticism about the formation of “clubs” of arbitrators, who allegedly would generate imperfections in the market and overthrow this tendency to reduce the sums of fees (in reality, specialty reduces costs, increases the reputational value of arbitration, the respectability of this

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16 For example, ICC, LCIA, ICDR. The well-known study periodically conducted by the law firm White & Case and by Queen Mary University of London, called the International Arbitration Survey, found in its 2015 edition that costs are deemed one of the worst characteristics of arbitration by 68% of interviewees. On the other hand, when those interviewed were asked about their preferences for arbitration institutions (ICC 68%, LCIA 37%, HKIAC 28%, SIAC 21%), the overall cost of service criterion appears in 9th place as the criterion of choice of these arbitral institutions. Available at: <http://www.arbitration.qmul.ac.uk/docs/164761.pdf>.


19 YVES DEZALAY and BRYANT GARTH, in several moments refer in their book to the arbitrators “club”. In the specific chapter regarding the “profession” of the arbitrator, the authors state that: “without a suitable platform, defined now as more than social class (which is nevertheless useful), the arbitration devotee can ever get selected as an arbitrator. There are individuals who, for example, teach at low-prestige schools, work in unknown law firms, or produce scholarship that is deemed to be too marginal, who cannot gain access to this world no matter how much they write, attend conferences, or in general profess the Faith. Others need not even profess the Faith or write about arbitration to enter the field more or less at the top. One of those who fits the profiles of those just described stated simply, it is ‘not that hard to get into the club’.” (DEZALAY, Yves; GARTH, Bryant G. Dealing in Virtue. Chicago: The University of Chicago Press, 1996).
II.C The reduction of delay costs in property allocation

In spite of the critiques to the practice that the arbitral proceedings are becoming more and more complex and time-consuming delayed, probably due to the increasing complexity of progressively more globalized business, delay is still pointed out as one of the main advantages of arbitration, especially in markets where jurisdiction is dilatory, which is the case in Brazil. In economic terms, this advantage may reduce costs linked to the delay in allocating property.

There is much evidence that arbitration tends to and may be a fast procedure speedy. First of all, this doctrine ensures the choice of the procedure that will be used. The parties may establish boundaries and deadlines for the arbitral tribunal to render a decision. Even if a ruling is given after the deadline is not considered void20; there is a possibility of claiming damages from the arbitrator who did not comply with the deadline21.

In addition, there are many regulations providing for expedited arbitration and different chambers22, which establish speedy proceedings. It is also possible to adopt final offer arbitration23, which, very common in the United States, apart from accelerating the proceeding, also favors the

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20 The 2013 Corporate Choices in International Arbitration: Industry Perspective (available at http://www.arbitration.qmul.ac.uk/research/2013/index.html) points out the arbitrator’s expertise as an advantage. Despite being expense, the market understands that the arbitrator’s expertise is the main factor that determines the choice of arbitration. As concluded by the 2015 International Arbitration Survey (available at http://www.arbitration.qmul.ac.uk/research/2015/index.html), 38% of those interviewed believed that the possibility of choosing the arbitrator, according to his expertise, for the specific case, is one of the three most important characteristics of arbitration.

21 Article 32, item VIII, of Brazilian Law n. 9,307/96, regulates the events of nullity of the arbitral award, in cases where the deadline provided in article 17, item III, has passed (time limit for the presentation of the arbitral award), provided that the interested party has notified the arbitrator, or the president of the arbitral tribunal, granting him a time limit of ten days to render and present the arbitral award. It is urged to stress that non-compliance with the deadline enables the filing of a nullity lawsuit.

22 In the case of Brazilian law, apart from nullity of the award, arbitrators may be held liable for damages caused with their negligence. In the absence of precedents, a part of jurists believes that the arbitrator answers for “errors in procedendo”, i.e. for mistakes made with regards to procedure and which bring the annulment of the arbitral award. The liability reaches only the arbitrator who made the mistake.

In other jurisdictions, the point of view is similar. In France, for example, jurists find that an arbitrator who does not respect deadlines in arbitrations may incur in civil liability, provided that his fault is proven. See CLAY, T. (2000). L’arbitre. Paris, [s.n.]. Page 708.

23 See the Expedited Arbitration Regulation of the FGV Chamber of Conciliation and Arbitration, of the Chamber of Mediation and Arbitration of the Commercial Association of Paraná – ARBITAC, or of the Chamber of Conciliation, Mediation and Arbitration of the Industrial Center of the State of Rio Grande do Sul – CAMERS.

24 “Final offer arbitration”, also known as “Baseball arbitration” or “Last, bet offer”, is a procedure frequently used in the United States, where the arbitrator no longer has the freedom to decide and is forced to choose one of the two proposed awards presented by each one of the parties. The arbitrator, instructed by the parties, must choose between the final offers made before finalizing the negotiation stage. Final offer arbitration is also called baseball arbitration because it was initially used to solve salary-related conflicts between U.S. baseball league players and the owners of the teams.
transition between the parties\textsuperscript{27}, reducing the time of property allocation and, consequently, the related costs\textsuperscript{28}.

Added thereto is the fact that, as a general rule, arbitration does not admit appeals, which consequently results in a much faster allocation of property\textsuperscript{29}.

Celerity of the proceeding is also supplemented by the fact that any language, or even more than one, can be adopted, removing any need for time-consuming sworn translations. Informality, which is inherent to the idea of arbitration, is an endless source of solutions created by practice, which make the adoption of speedy procedures possible for dispute resolution and, consequently, reducing costs incurred in the delay of property allocation.

Finally, it is important to highlight that arbitration, because it presents decisions with higher likelihood of settlement, as will be discussed below, shows higher rates of spontaneous compliance with a decision, which avoids the execution or judgment compliance phase, therefore, culminating in a reduction of delay costs of property allocation.

II.D The reduction of costs due to mistakes in judgments

The adjudicating entity in arbitration is the arbitral tribunal, composed of arbitrators, who are none other than human beings invested with jurisdictional powers. Just as in arbitration, any adjudicator invested in such powers, who will put an end to a dispute and will allocate property rights (parties’ assets), is prone to error, considering that their rationality and information are limited\textsuperscript{30}. After all, the possibility of mistakes is inherent to human condition.

It follows that the mere existence of the probability of error generates an economic cost, that is, of the probability of incorrect allocation of property rights (mistake of the decision). Accordingly, it is understandable that arbitration is capable of reducing the cost of this mistake due to at least two reasons.

In the first place, the possibility of appointing specialists as arbitrators allows a significant decrease of the risk of mistakes in judgments. The idea of arbitration usually guarantees to the parties the freedom to elect arbitrators who are specialists and who do not need to have a legal education, which allows the parties to, for example, appoint an adjudicator with experience in the matter under dispute, to interpret complex legal and business structures, which indicates a lower asymmetry and higher availability of information to the adjudicator. After all, the adjudicators’ expertise has been


\textsuperscript{27}Drahozal gives the example of low-cost arbitrations (expedited arbitrations), stating that these can be an accessible method: “Second, for employees and consumers with small and mid-sized claims, the availability of low-cost arbitration makes arbitration an accessible forum, and possibly a more accessible forum than litigation” (DRAHOZAL, G. R. (2008) Arbitration Costs and Forum Accessibility: Empirical Evidence, 41 U. MICH. J.L. REFORM 813, 826-31).

\textsuperscript{28}In most legal systems there is no provision for arbitration appeal. Nevertheless, some jurisdictions accept it, which is England’s case. In accordance with Section 69 of the 1996 Arbitration Act, it is possible for parties to appeal an arbitral awards rendered by the Arbitral Tribunal constituted with seat in the United Kingdom, before the country’s Judiciary. Notwithstanding, the cases of application of said appeal are very restricted. In addition, it is important to point out that the parties must request the Judiciary’s approval for such appeal. Paragraph 3 of Section 69 of the 1996 Arbitration Act lists the material requirements (the formal requirements can be found in paragraph 2) for the Judiciary to authorize the filing of the appeal on point of law. In short, the Judiciary only allows an appeal to be filed against an arbitral award if: (a) the subject-matter of the appeal substantially affects the rights of the party(ies); (b) the decision of the Arbitral Tribunal is obviously wrong; (c) the question is of great importance to the general public.

recognized by the parties as an essential criterion to adopt arbitration. It is important to note that the cost of the arbitrator’s education during the procedure constitutes is lower when compared to that of a magistrate, since the latter is frequently unfamiliar with the practices of the market under dispute, considering that the arbitrator generally has lesser asymmetry of information than the magistrate with regards to usage and practices, as well as to the more specialized legal rules.

In addition, arbitration provides also has the advantage of the financial incentives to the arbitrators have to render give a better decision in award. This is mainly due to the fact that it being it is a professional services market. Nevertheless, the arbitrator, like every economic agent, needs reputation in order to continue being appointed in future arbitral tribunals. However, it is known that the frequency of appointment, the values in dispute and the consequent amount of the remuneration will be higher the better the arbitrator’s reputation is. The acknowledgement by the arbitral community and the market in general that the arbitrator is a bad professional or that he gave a wrong ruling will result in serious harm to his reputation and will certainly void future appointments. The need to maintain his reputation irreproachable and to preserve his symbolic capital is what makes arbitration provides good economic incentives for the arbitrator not to be partial and free him to be precise. The bigger the incentive in the sense of a correct and neutral decision, the lower the likelihood of mistakes, and the lower the transaction cost.

A career magistrate does not have the same incentive, because he is not chosen; he operates as a result of forensic distribution (which will guarantee impartiality in the scope of public justice). There would be reputational control through judicial appeal and career progression (for merit) would depend on it. However, Brazilian courts unfortunately have barely used progression by merit, preferring the more comfortable political solution of seniority.

Finally, for the sake of the argument, the absence of appeal to arbitral awards, much feared by economic agents and arbitration users, must be rebutted. Even if the cost of the mistake is aggravated by the fact that no ratification of the decision is possible, this encumbrance is diminished by the incentives to give a better ruling, argued above, and compensated by cost reduction of allocation of property, provided by a procedure that does not allow appeal. At the appeal level, the probability of occurring a new mistake, or, even worse, of reversing or overturning a correct decision, weakens any support to this argument.

II.6 The reduction of costs due to the publicity of the procedure

Judicial proceedings are in general public, in accordance with the principle of publicity which governs civil procedure. Nevertheless, this can be very dangerous for companies because internal and confidential information of companies are often discussed, and, when disclosed, they can become an obstacle to its good operation, decrease its market value and even threaten its existence.

On the opposite direction, the idea of arbitration ensures that the parties are able to establish a dispute resolution mechanism that is absolutely confidential. Even though an express provision of a general rule of this kind does not exist in the Brazilian Arbitration Law, for example, the arbitration market generally adopts it, if not expressly in the arbitration agreement, then indirectly through the adoption of an arbitration regulation that provide for it.\(^\text{[30]}\)

\(^{30}\) As the 2015 International Arbitration Survey concludes (Available at: http://www.arbitration.gmu.ac.uk/docs/164761.pdf >), for 38% of those interviewed, the possibility to choose the arbitrator, according to his expertise, for a specific case, is one of the three most important characteristics of arbitration.


\(^{32}\) Most arbitration regulations of the main chambers in the world provide for confidentiality. For example: CAM-CCBC (art. 14); FIESP (art. 17.4); CAMARB (art. 12.1); CAMERS (art. 17.4); CCI (art. 6); LCIA (art. 30); ICDR-AAA (art. 37)
This guaranty of preserving said information is a potential minimizer of transaction costs, since confidentiality reduces significantly the risk of leaking privileged information on product development, conducted research, potential markets, and information that could possibly be used by competitors, such as know-how and industrial secrets\textsuperscript{33}. If access to the proceedings' documents were public, which is the case of judicial proceedings\textsuperscript{34}, the risks of elevated transaction costs would be evident.

In addition, confidentiality protects the reputation of the companies. Shavell explained the situation of companies that were sued for producing a product with a certain defect. In his conception, it is reasonable to imagine that a company does not intend for a certain information to become public knowledge, because its image and reputation, for example, would be damaged\textsuperscript{35}. It is not a coincidence that, in the CBAr/Ipsos\textsuperscript{36} research, it was proven that corporate legal managers value substantially this characteristic of arbitration in comparison to the judiciary.

The idea of arbitration, by also granting the possibility of confidential dispute resolution procedures, can lead to the reduction of transaction costs.

II.F The reduction of costs due to procedure inefficiency

Arbitration can reduce procedure inefficiency costs not only when the law enforces the power of the arbitration clause, but mainly when it recognizes and benefits the enforcement of an arbitral award in the vast majority of countries.

Now, when a dispute resolution method is unable to effectively allocate a patrimony as agreed upon by the parties and as provided by the Law, it is considered ineffective.

Arbitration reduces inefficiency costs considering that the arbitral award is very easily recognized in courts and benefits from an important instruments which guarantee recognition and enforcement in many foreign jurisdictions, such as the 1958 New York Convention\textsuperscript{37}. In this scenario, the cost of inefficiency is decreased in arbitration because from the moment an arbitral award is rendered in Brazil, for example, it has a higher chance of being enforced abroad than a judgment given by a Brazilian court does.

As previously stated, the idea of arbitration generates a higher probability of spontaneous judgment enforcement, because guarantees the possibility of a higher level of confidence in the adjudicators and of accuracy in the decision, demonstrating a higher chance of procedure effectiveness, which culminates in a higher incentive for the parties to take more precautions in order to respect the obligations they undertook.

Following this train of thought, the more effective the method of conflict resolution that will govern the legal relationship, the lower the procedure inefficiency cost, and the lower the transaction cost.

\textsuperscript{33} The commercial secret binds different internal sectors of a company, such as techniques and strategies for attracting clients, models of projected revenues and of profits, particular aspects of investigation and development projects, particular aspects of activities developed by an active company in the trade, progress made by an entity in any area, designs of new products or prototypes, and other information in general about the internal life of the companies. (GONÇALVES, Renato. Acesso à informação das entidades. Coimbra: Almedina, 2002, p. 137.)


\textsuperscript{36} Disponível em: www.char.org.br/PDF/Pesquisa_CBAr-Ipsos-final.pdf.

\textsuperscript{37} The 1958 New York Convention currently has legal force in 156 countries, which have already ratified the convention. Available at: <http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html>.
III. OPPORTUNITY COSTS DERIVED FROM NOT ADOPTING ARBITRATION IN BRAZIL

Simply put, the analysis of opportunity cost is based on the loss of the utility which would be obtained with the disadvantaged choice. Thus, as it is believed that transaction costs of a commercial contract in which arbitration is not adopted (or where the judiciary is chosen) are higher than those of a contract which provides for arbitration, one concludes that the cost of opportunity cost, or not choosing arbitration, covers the difference between the transaction costs in both situations. In other words, by not opting for arbitration, the cost which could have been saved with its adoption is lost.

Before demonstrating the opportunity costs, it is important to mention that to not adopt arbitration implies necessarily and implicitly the choice of the judiciary, considering that there is no such thing as mandatory arbitration or an alternative dispute resolution method. It is indeed legitimate to question whether there would actually be an opportunity cost when one chooses the judiciary, since there would not in fact be a positive choice, as the judiciary will always exist, in accordance with the constitutional principle of access to justice. However, this argument falls apart from the moment the legislator, in countries such as Brazil, as occurs in most civilized countries, made it possible for economic agents who exchange between each other to consent to arbitration. Consequently, the opportunity cost, therefore, the cost of opportunity, will always be present.

When dealing specifically with the case of Brazil, one must determine the opportunity cost generated by the lack of choice of arbitration, which necessarily implies an assessment of the Brazilian judicial system. This analysis stems from two criteria, which are the delay in allocation of property (A) and the structure of the Brazilian judiciary’s incentives (B). It is focused on the procedural system and reality of the judicial system, supported by Brazilian procedural law, which for the purposes of this research is still the old and inadequate one, considering that its most recent change has not yet shown the results it intended to bring.

III.A The delay in property allocation by the Brazilian Judiciary

As previously mentioned, the delay in allocation of property rights is one of the elements that bring the highest transaction costs. Taking into account that the judiciary is considered very slow in Brazil, to not opt for arbitration presents an elevated opportunity cost. Before observing empirical

37 Access to justice is provided for in article 5, XXXV of the Brazilian Federal Constitution, which states that: “the law shall not exclude harm or threat to a right from the Judiciary Branch’s examination”. This may also be called principle of non-obliteration of the judicial control or principle of drositual action. By interpreting the letter of the law, this means that everyone has access to justice to file a lawsuit in order to obtain preventive or compensation judicial relief with regards to a right. Article 8, I, of the Interamerican Convention on Human Rights – San José of Costa Rica (ratified in Brazil), also describes that: “Every person has the right to a hearing, with due guarantees and within a reasonable time, by a competent, independent, and impartial tribunal, previously established by law, in the substantiation of any accusation of a criminal nature made against him or for the determination of his rights and obligations of a civil, labor, fiscal, or any other nature”.

38 As a general rule, arbitration is consensual by nature. Exceptionally, some countries provide for mandatory arbitrations. Mandatory arbitration is that which the State imposes mandatorily on the parties to solve certain types of conflicts by means of arbitration. Although it exists in some countries, this type of arbitration does not exist in Brazil. One of the examples is Portugal, where a voluntary arbitration law exists and where there are provisions of mandatory arbitration in other laws for certain matters.

39 Only the data from the State Courts, competent to rule on civil and commercial cases, arbitrable subject-matter in Brazil, are to be taken into account here.

40 The New Civil Procedure Code (Brazilian Law n. 13,105/2015) came into force on March 18, 2016, bringing many innovations intended to expedite the proceeding. Nevertheless, only time will tell if it will actually change the reality of State Courts.
data, one must only keep in mind the time that elapses between the filing of the lawsuit’s initial petition and the moment the judgment becomes final (res judicata), in order to establish a comparison with the duration of arbitration, considering the time between the registration of the request for arbitration and the issuance of the arbitral award.

Furthermore, the cost of the delay generated by the judiciary is exacerbated since it is not only restricted to the utility that the property would have, because the extension itself of judicial proceedings in time generated other costs derived from the increased intensity of the litigation. For a better comprehension of the argument, the analysis of the following two charts is recommended:\(^{41}\)

\[\text{Graph 01}\]

\[\text{Graph 02}\]

By analyzing the charts, it is possible to come to the following conclusions: i) as the dispute lasts through time, the intensity of the conflict tends to increase exponentially (Chart 01); ii) the cost of conflict resolution varies according to the level of hostility in the dispute (intensity of the conflict), i.e. the higher the level of litigiousness of the conflict, the higher its cost (Chart 02); iii) furthermore, the litigiousness increases progressively as time goes by.

Faced with such premises, it is frightening to imagine the opportunity cost paid by entrepreneurs’ dissatisfaction with the operation of (public) justice. In Brazil, as supported by the information the author collected, the Judiciary’s deficiencies derive essentially from its institutional profile and its administrative structure. Several data brought to light by said profession deserve to be highlighted.

First of all, when asked about the Judiciary’s performance, 60.9% of Brazilian entrepreneurs rated its agility as “terrible”, 42.7% rated its impartiality as “regular”, and 25% rated its costs as “bad”.

However, the aforementioned research’s most remarkable finding, for the purpose of this essay, refers to the impacts the Judiciary’s bad functioning and inefficiency have on the firm. The entrepreneurs who were interviewed were questioned as follows:

“The Judiciary is the Branch responsible for ensuring the correct compliance with the law and with contracts, protecting the property right, and defending citizens and companies


against eventual arbitrariness by the State. It has been stated that the Brazilian Judiciary’s deficiencies in certain states elevates the risk and/or the cost of doing business, hiring workforce, working with the public sector, and making investments in certain states. We would like to know if at any point in time the costs or the lack of trust in the Judiciary’s agility or impartiality were the main factor which led your company to:

For 48.2% of those interviewed, the result of the research was “yes” to “not do, or do less business with state-owned companies or with public administration”, 50% said “yes” to “not do business with a certain person or company”, and 21.2% answered “yes” to “not make an investment which otherwise you would have gone ahead with."

To demonstrate the dilatoriness of the Judicial system vis-à-vis matters of corporate law and capital market law, for example, Viviane Müller Prado conducted a thorough research (and significant in terms of sampling) of jurisprudence at the Court of Justice of the State of São Paulo and at the Superior Court of Justice43. One of the noteworthy findings was that the total duration of trial of one proceeding (first and second instances) varies between the minimum of 233 days and the maximum of 3,993 days. With regards to the capital market, the total duration is of at least 888 days, and 5,049 days at the most, making an average of 2,618 days.

On the other hand, in arbitration, the average duration is much shorter, and it varies according to the complexity and value of the dispute. As a first example, a report issued by the AAA/ICDR44 informs that arbitrations worth up to US$ 75,000.00 last an average of 175 days, those worth US$ 499,999.99 last 279 days, and those worth up to US$ 999,999.99 last 356 days, reaching an average of 474 days for arbitrations worth more than US$ 10,000,000.00. As for LCLA arbitrations, the average duration is of 16 months until the final ruling45. In an institution with seat in Brazil, the Amcham Arbitration and Mediation Center, the average duration was also of 16 months46.

It should also be noted that such time frames exist, mostly at international institutions, in arbitrations that have a complexity and higher value than the proceedings under way in the Brazilian judicial system.

Accordingly, the cost of opportunity cost that arises when not choosing arbitration is partially composed by the long delay in allocation of property rights, which seems to correspond to the utility that the property could have provided to the holder of the right by the difference between

43 In a short-term analysis, in most cases, for these companies the cost of the arbitral proceeding will be much higher than the judicial discussion of a corporate conflict. Nonetheless, on the long term, this equation tends to be altered by virtue of celerity and expertise of arbitration as opposed to the slowness, large number of appeals, and inefficiency of the judiciary branch when dealing with such issues. For an in-depth analysis on the subject see PRADO, Viviane Muller; BURANELLI, Vinicius Correa. Pesquisa de jurisprudência sobre o direito Societário e Mercado de Capitais no Tribunal de Justiça de São Paulo. In: Caderno Direito da Fundação Getúlio Vargas, Volume 2, nº 1, Janeiro de 2006. According to the study, the information used for the research refer to the period between 1998 and 2005; specifically, until the month of September, 2005; The study reveals that in local systems where there is insufficient protection for investors, the capital market is less developed when compared to other systems where such rights are respected. This lack of relief is not only analysed from the standpoint of material law in force, but is mainly considered the absence of enforcement of corporate and capital market laws.


the time of rendition of the arbitral award (earlier) and the moment the judicial decision is final, res judicata (later). This alone explains how the cost of opportunity, cost incurred by not adopting arbitration is evident when one knows, at least when the lack of its choice leads to the Brazilian judiciary, that the delay in allocation of property will presumably be longer.

III.B  The alleged lack of incentives in the Brazilian judiciary

In order to comprehend the opportunity cost incurred when one does not choose arbitration, it is equally important to understand the supposed lack of incentives that the judiciary system provides.

Before presenting any sort of argument, it is important to remember that judges do not have the same incentives arbitrators do. As a Judge, POSNER pointed out the difficulty to “identify the incentives and constraints that shape the behavior of workers whose work is structured as to eliminate the common incentives and constraints of the workplace” 47. Indeed, adjudicators do not have the same marketing incentives to seek qualification, not due to incompetence or lack of motivation, but due to the judiciary’s own incentives structure. As much as the judiciary is able to compensate judges with salaries at the highest levels of national public offices, it cannot offer, in essence, a compensation method which incentivizes the production or specialization that the arbitration market can. Arbitration, therefore, permits adjudicators with the maximum qualification and reputation to be chosen.

The judiciary’s lack of equipment is also to be considered. It is indeed almost impossible for a first instance judge from certain judicial districts to be able to specialize in some commercial area and, in some situations, even dedicate himself to cases. Several different reasons lead to this situation.

First of all, as was contended, there is a problem of lack of structure to deal with the millions of judicial proceedings that overload the judiciary. In practice, this reality often prevents judges from being completely dedicated, making them miss incentives to render the best decision. Better to have “many judgments” than “a few better judgments”.

Second of all, in several judicial district courts, the magistrate can be found in the condition of generalist, being called to rule on the most varied of subject-matters, excluding in the majority of cases that which falls under the labor or federal courts’ jurisdiction. It is indeed reasonable to imagine that the inability to specialize in a certain area brings, in some cases, the loss of quality in judgments, resulting in higher odds of mistake and lesser efficiency.

Therefore, by not opting for arbitration, the cost of opportunity cost clearly increases with the possibility to choose an adjudicator who is, in theory, more specialized, without the limitations presented by the judiciary.

IV. CONCLUSIONS

Arbitration only exists if adopted by the parties, which imposes a choice. The outcome of such choice for arbitration, motivated by the maximization rational economic agent, is none other than that of the attempt to reduce transaction and opportunity costs which are present in contractual relationships. As discussed, the various characteristics of the doctrine of arbitration must be analyzed from the economic approach to law, taking into account the transaction and opportunity costs. Accordingly, companies and economic agents should not limit themselves to merely consider the perhaps elevated direct and financial costs of arbitration, but should always assess and verify if its characteristics mentioned herein will indeed reduce transaction and opportunity costs.

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